

COMMONWEALTH OF PUERTO RICO

Basic Financial Statements
and Required Supplementary Information

June 30, 2018

(With Independent Auditors' Report Thereon)

BASIC FINANCIAL STATEMENTS AND REQUIRED SUPPLEMENTARY INFORMATION

Fiscal Year Ended June 30, 2018



Commonwealth of Puerto Rico

***Honorable Pedro Pierluisi Urrutia
Governor***

Prepared by:

Puerto Rico Department of the Treasury

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Independent Auditors' Report

The Honorable Governor and Legislature
Commonwealth of Puerto Rico
San Juan, Puerto Rico

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Commonwealth of Puerto Rico (the Commonwealth) as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprise the Commonwealth's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the following entities and funds:

- *Governmental Activities*
 - Corporation of Industries for the Blind and Mentally Retarded and Incapacitated Persons of Puerto Rico, Office of Legislative Services, Office for the Improvement of Public Schools, Superintendence of the Capitol Building, Puerto Rico House of Representatives, Puerto Rico Senate, Puerto Rico Public Housing Administration, Puerto Rico Housing Finance Department – Sales and Acquisition Fund, and Puerto Rico Department of Economic Development and Commerce, which collectively represent 8.06% and 2.65% of the total assets and revenues, respectively, of the General Fund.
 - Puerto Rico Maritime Shipping Authority, Special Communities Perpetual Trust special revenue and debt service funds, Public Buildings Authority, University of Puerto Rico Comprehensive Cancer Center, Puerto Rico Infrastructure Financing Authority, The Children's Trust, Puerto Rico Fiscal Agency and Financial Advisory Authority, and Ponce Authority, which are non-major governmental funds that represent 20.59% and 8.61% of the total assets and revenues, respectively, of the aggregate remaining fund information.

These entities and funds collectively represent 35.26% and 3.03% of the total assets and revenues, respectively, of the governmental activities.

- *Business-Type Activities*
 - Unemployment Insurance Fund, which is a major enterprise fund.
 - Puerto Rico Health Insurance Administration, which is a major enterprise fund.
 - Puerto Rico Medical Services Administration, which is a major enterprise fund.



- The Additional Lottery System, the Puerto Rico Water Pollution Control Revolving Fund, Puerto Rico Safe Drinking Water Treatment Revolving Loan Fund, the Governing Board of 9-1-1 Services, Disability Insurance Fund, Drivers' Insurance Fund, and Ponce Ports Authority, which are non-major enterprise funds that collectively represent 25.93% and 51.58% of the total assets and revenues, respectively, of the aggregate remaining fund information.

These entities and funds collectively represent 97.04% and 92.09% of the total assets and revenues, respectively, of the business-type activities.

- *Aggregate Discretely Presented Component Units*

The discretely presented component units listed in note 1(c) to the basic financial statements. These entities collectively represent 74.93% and 59.56% of the total assets and revenues, respectively, of the aggregate discretely presented component units.

Those statements were audited by other auditors whose reports have been furnished to us, and our opinions, insofar as they relate to the amounts included for the entities and funds indicated above, are based solely on the reports of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Summary of Opinions

<u>Opinion unit</u>	<u>Type of opinion</u>
Governmental activities	Unmodified
Business-type activities	Unmodified
Aggregate discretely presented component units	Qualified
General fund	Unmodified
Debt service fund	Unmodified
ERS Special evenue fund	Unmodified
COFINA Special revenue fund	Unmodified
COFINA Debt service fund	Unmodified
Unemployment insurance fund	Unmodified
Puerto Rico Health Insurance Administration Fund	Unmodified
Puerto Rico Medical Services Administration Fund	Unmodified
Aggregate remaining fund information	Qualified



Basis for Qualified Opinions (Scope Limitation) for Aggregate Discretely Presented Component Units and Aggregate Remaining Fund Information

Basis for Qualified Opinions – Unaudited Contingency and Compensated Absences Amounts

We were unable to obtain sufficient appropriate audit evidence regarding an accrual for legal contingency of approximately \$212 million and regarding accrued compensated absences in the amount of approximately \$108 million recorded in the 2018 financial statements of the Puerto Rico Electric Power Authority (PREPA), a discretely presented component unit of the Commonwealth.

Basis for Qualified Opinions – Unaudited Pension Amounts

The Additional Lottery Fund and the Governing Board of 9-1-1 Fund, which were audited by other auditors, applied the provisions of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, in their respective separately issued financial statements. However, based on the lack of availability of audited pension amounts from the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico at the time of the respective issuance of their financial statements, the other auditors qualified their opinions due to the lack of sufficient appropriate audit evidence on the pension amounts, including net pension liability, deferred outflows of resources, deferred inflows of resources, and pension expense. Accordingly, we were not able to obtain sufficient appropriate audit evidence about the pension amounts included in the financial statements of the Aggregate Remaining Fund Information. The net pension liability, deferred outflows of resources, deferred inflows of resources, and pension expense included for these funds in the financial statements of the Aggregate Remaining Fund Information for the Commonwealth were \$61.2 million, \$20.1 million, \$1.2 million, and \$0, respectively.

Basis for Qualified Opinions – Unaudited Cash Balance

The financial statements of the Disability Insurance Fund and the Driver's Insurance Fund (the Disability and Driver's Funds) as of June 30, 2018 were audited by other auditors, whose report thereon, dated March 21, 2019, include a "Basis of Qualified Opinion" paragraph stating that the Disability and Driver's Funds did not maintain adequate accounting records and reconciliation procedures over its cash held by the Puerto Rico Secretary of Treasury amounting to \$60.7 million as of June 30, 2018, and were unable to obtain sufficient appropriate audit evidence regarding such balance. Accordingly, we were also unable to obtain sufficient appropriate audit evidence regarding the adequacy of such balances included in the financial statements of the Aggregate Remaining Fund Information of the Commonwealth as of June 30, 2018.

Qualified Opinions

In our opinion, based on our audit and the report of other auditors, except for the possible effects of the matters described in the "Basis for Qualified Opinions (Scope Limitation) for Aggregate Discretely Presented Component Units and Aggregate Remaining Fund Information" paragraphs, the financial statements referred to above present fairly, in all material respects, the respective financial position of the aggregate discretely presented component units and aggregate remaining fund information as of June 30, 2018, and the respective changes in financial position thereof for the year then ended in accordance with U.S. generally accepted accounting principles.

Unmodified Opinions

In our opinion, based on our audit and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities and each major fund of the Commonwealth of Puerto Rico as of June 30, 2018, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with U.S. generally accepted accounting principles.



Emphasis of Matters

Uncertainty about Ability to Continue as a Going Concern – Primary Government

The accompanying basic financial statements have been prepared assuming that the Commonwealth will continue as a going concern. As discussed in note 2(a) to the basic financial statements, the Commonwealth is in the midst of a fiscal, economic and liquidity crisis, an economic recession, high unemployment rate, a population decline, high levels of debt and pension related obligations, and has stated that substantial doubt exists about the Commonwealth's ability to continue as a going concern. Additionally, on May 3, 2017, the Financial Oversight and Management Board (the Oversight Board) at the request of the Governor, filed a petition for relief under Title III of the U.S. Congress Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) in the United States District Court for the District of Puerto Rico. Management's evaluation of the events and conditions and management's plans regarding these matters are also described in note 2(a). The basic financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinions on the basic financial statements are not modified with respect to this matter.

Uncertainty about Ability to Continue as a Going Concern – Major Discretely Presented Component Units

The accompanying basic financial statements have been prepared assuming that the major discretely presented component units of the Commonwealth will continue as a going concern. As discussed in note 2(b) to the basic financial statements, the Commonwealth has stated that substantial doubt exists for the following major discretely presented component units to continue as a going concern. Management's evaluation of the events and conditions and management's plans in regard to these matters are described in note 2(b) to the basic financial statements. The basic financial statements do not include any adjustments that might result from the outcome of these uncertainties. Our opinions on the basic financial statements are not modified with respect to these matters.

- *Government Development Bank for Puerto Rico (GDB)*

The financial statements of GDB as of June 30, 2018 and for the year then ended were audited by other auditors, whose report thereon, dated March 2, 2021, included an emphasis of matter paragraph related to GDB's ability to continue as a going concern. As stated in GDB's independent auditors' report, the Commonwealth and its component units have not been able to repay their loans from the GDB, which has significantly affected GDB's liquidity and ability to repay its obligations. In addition, on March 23, 2018, GDB ceased its operations and determined to wind down in an orderly fashion under Title VI of PROMESA.

- *Puerto Rico Highways and Transportation Authority (PRHTA)*

The financial statements of PRHTA as of June 30, 2018 and for the year then ended were audited by other auditors, whose report thereon, dated March 25, 2019, included an emphasis of matter paragraph related to PRHTA's ability to continue as a going concern. As stated in PRHTA's independent auditors' report, PRHTA has had significant recurring losses from operations, does not have sufficient funds available to fully repay its various obligations as they come due, and has defaulted on the payments of principal and interest on multiple bond series and lines of credits. Also, on May 21, 2017, the Oversight Board, at the request of the Governor, commenced a case for PRHTA by filing a petition for relief under Title III of PROMESA in the United States District Court for the District of Puerto Rico.

- *Puerto Rico Electric Power Authority (PREPA)*

PREPA has an accumulated deficit of approximately \$6.8 billion as of June 30, 2018, does not currently have sufficient funds available to fully repay its various obligations as they come due, and has defaulted on the payment of various debt obligations. Also, on July 2, 2017, the Oversight Board, at the request of the Governor, filed a petition on behalf of PREPA for relief under Title III of PROMESA in the United States District Court for the District of Puerto Rico.



- *University of Puerto Rico (UPR)*

The financial statements of UPR as of June 30, 2018, and for the year then ended were audited by other auditors, whose report thereon, dated April 29, 2019, included an emphasis of matter paragraph related to UPR's ability to continue as a going concern. As stated in UPR's independent auditors' report, UPR is highly dependent on the Commonwealth's appropriations to finance its operations.

Restatement of Net Position

As discussed in note 4 to the basic financial statements, the net position of the aggregate discretely presented component units as of July 1, 2017 has been restated to correct misstatements. Our opinions are not modified with respect to this matter.

Adoption of New Accounting Pronouncement

As discussed in notes 1(bb) and 4 to the basic financial statements, the Commonwealth adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. Our opinions are not modified with respect to this matter.

Change in Reporting of Pension Trust Funds

As discussed in notes 1(b), 4, and 18 to the basic financial statements, as a result of the enactment of Act 106 of August 23, 2017, the pension trust funds established to pay the accumulated pension benefits of the Employees' Retirement System of the Government of the Commonwealth of Puerto Rico, the Puerto Rico System of Annuities and Pensions for Teachers, and the Retirement System for the Judiciary of the Commonwealth of Puerto Rico, were eliminated and the legacy trust funds are now reported as blended component units within governmental activities. Our opinions are not modified with respect to this matter.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 7 through 27; the schedules of changes in the net pension liability for single-employer pension plans on pages 258 and 259; the schedule of proportionate share of the net pension liability of a cost-sharing multiple-employer pension plan on page 260; the schedule of employers' contributions for all pension plans on page 261; the schedule of changes in total other postemployment benefits liability and related ratios for single-employer pension plans on pages 262–264; and the schedule of revenue and expenditures – budget and actual–budgetary basis – General Fund on page 265, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context.

We were unable to apply certain limited procedures to the management's discussion and analysis in accordance with auditing standards generally accepted in the United States of America, due to the matters described in the "Basis for Qualified Opinions (Scope Limitation) for Aggregate Remaining Fund Information", and the "Basis for Qualified Opinion (Departure from U.S. Generally Accepted Accounting Principles) for Aggregate Remaining Fund Information". Additionally, although our opinions on the basic financial statements are not affected, the financial statement amounts included in the management's discussions and analysis contain material departures from U.S. generally accepted accounting principles because they do not include pension and OPEB amounts for certain entities and funds that did not apply the provisions of GASB Statement No. 68 and GASB Statement No. 75, respectively. We do not express an opinion or provide any assurance on the information.



We and the other auditors have applied certain limited procedures to the schedules of changes in the net pension liability for single-employer pension plans; the schedule of the Commonwealth's proportionate share of the net pension liability of a cost-sharing multiple employer pension plan; the schedule of employers' contributions for all pension plans; the schedules of changes in total other postemployment benefits liability and related ratios for single-employer pension plans; the and the schedule of revenue and expenditures - budget and actual - budgetary basis - General Fund, in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplementary and Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Commonwealth's basic financial statements. The combining and individual fund financial statements and schedules listed in the accompanying table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The combining and individual fund financial statements and schedules are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, except for the effect on the supplementary information of the matters described above in the "Basis for Qualified Opinions (Scope Limitation) for Aggregate Discretely Presented Component Units and Aggregate Remaining Fund Information" and, the "Basis for Qualified Opinion (Departure from U.S. Generally Accepted Accounting Principles) for Aggregate Remaining Fund Information" paragraphs, the combining and individual fund financial statements and schedules are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

KPMG LLP

San Juan, Puerto Rico
June 30, 2021

Stamp No. E434360 of the Puerto Rico
Society of Certified Public Accountants
was affixed to the record copy of this report.

COMMONWEALTH OF PUERTO RICO

Notes to Basic Financial Statements

June 30, 2018

On November 6, 2018, the District Court approved GDB's Qualifying Modification under Title VI of PROMESA and the Qualifying Modification became effective as of November 29, 2018.

(ix) *PRIFA-Ports Exchange*

On December 27, 2019, PRIFA completed a private exchange that resulted in the resolution of over 92% of those certain Series 2011 bonds issued by PRIFA (Ports Authority Project) (the PRIFA-Ports Bonds). At the time of the exchange, the PRIFA-Ports Bonds were outstanding in an amount of approximately \$190.6 million. Bondholders holding approximately \$177.2 million participated in the private exchange and received their pro rata share (based on the entire amount of PRIFA-Ports Bonds outstanding) of a cash payment of approximately \$82.4 million, resulting in the full resolution of such participating PRIFA-Ports Bonds. The recovery the PRIFA-Ports bondholders received in the exchange is in addition to the GDB DRA Bonds received by the PRIFA-Ports bondholders in connection with a settlement of the bondholders' letter of credit claims against GDB, which settlement was entered into as part of the GDB Title VI Qualifying Modification. After the exchange, the PRIFA-Ports Bonds remain outstanding in the total aggregate amount of approximately \$13.5 million.

(d) **Default of Bond Principal and Interest Payments**

Because of the Commonwealth's retention of certain revenues conditionally allocated to public corporations and priority of payment provisions, as well as the Commonwealth's general financial condition, the Commonwealth and such public corporations were not able to make the debt service payments as they became due prior to the commencement of the Title III cases. Subsequent to the commencement of such cases, the automatic stay and other provisions of law have prevented payment of such amounts. The nature of the obligations of the Commonwealth and its public corporations to make such payments is currently the subject of ongoing litigation, as discussed in Note 17.

The table below summarizes the past due balance of principal and interest on bonds as of May 31, 2021 (in thousands):

	Principal	Interest	Past due Balance
Governmental activities:			
Commonwealth	\$ 1,997,586	3,538,622	5,536,208
PBA	322,733	934,180	1,256,913
PRIFA	311,190	415,354	726,544
ERS	—	582,816	582,816
PA	38,938	106,961	145,899
Total governmental activities	2,670,447	5,577,933	8,248,380
PFC appropriation bonds	194,830	324,830	519,660
Major component units:			
PRHTA	479,988	893,295	1,373,283
PREPA	1,339,916	1,626,472	2,966,388
PRASA	20,325	39,629	59,954
Total major component units	1,840,229	2,559,396	4,399,625
Nonmajor component units	86,407	90,058	176,465
Total	\$ 4,791,913	9,135,033	13,926,946